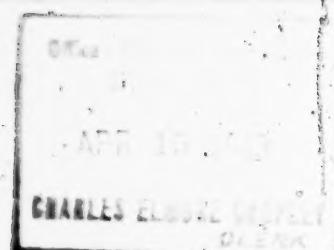


FILED



IN THE

Supreme Court of the United States

OCTOBER TERM—1942

No. 721

1

THE NORTH AMERICAN COMPANY,  
*Petitioner,*  
against  
SECURITIES AND EXCHANGE COMMISSION,  
*Respondent.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT  
COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF OF PETITIONER

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April, 1943.

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**REPLY BRIEF OF PETITIONER**

**I. THE COMMERCE POWER.**

Two principal theses pervade the argument in the Commission's brief based on the commerce power. The first is that petitioner's relationship to the enterprises in which it holds securities is not that "of a large investor seeking to promote the sound development of his investment" but that it "has control over" these enterprises (Brief, pp. 12-13, 27). The second is that petitioner in its communications and contacts with the corporations in which it owns securities, and otherwise, uses facilities of interstate commerce, such as interstate trains and telegraph and telephone lines, and the mails (Br. pp. 27-28).

These two theses are the Commission's sole answer to petitioner's contention that its ownership of the securities of which it has been ordered to divest itself is not commerce, interstate or intrastate, and accordingly is not within the reach of congressional power unless such ownership has been found to have a substantial effect on interstate commerce or a tendency to obstruct the power of Congress over it, and that this Court has before it no finding of such effect or tendency by the Commission, by any court or by Congress itself.

The Commission concedes (Br. p. 29) that the Act contains no provision for a finding by the Commission or by a court that the particular company subjected to an order under Section 11(b)(1) shall itself be engaged in interstate commerce or "that the situations corrected by the order shall in the particular case have an effect on interstate commerce". It makes only a half-hearted argument that Congress has made any express finding to that effect. Its chief contention on that head is that the very enactment of Section 11(b)(1) itself must be taken as a finding, even in the absence of any express declaration, that all registered holding companies so affect interstate commerce as to be properly subject to its terms (Br. pp. 29, 30).

The Commission also makes an argument, the exact bearing of which on our contentions is not wholly clear, that the Act, and Section 11(b) in particular, are "in the conservative tradition of federalism", because they do not undertake to cover the whole field but leave certain regulatory functions to the several states in which the operating utility companies are organized and do business.

We shall discuss these contentions of the Commission in the order in which we have stated them.

**a. The Commission's argument based on alleged "control" by petitioner of the corporations whose securities it owns.**

The Commission's position apparently is that, even though Section 11(b)(1) of the Act may not be constitutional as applied to all registered holding companies, it is constitutional as applied to petitioner, because petitioner must be considered to be of "interstate character" by reason of its "control" of its subsidiaries (Br. pp. 24, 29).

What the Commission means by "control" is made clear by its statement (Br. p. 27) that petitioner "controls its subsidiaries and that *their acts are its acts*".\* It has to adopt that meaning of "control" to make its point. The kind of "control" which is involved in the mere ownership of a large enough proportion of the voting stock of a company to influence the selection of a competent management would not suffice. That is simply a normal incident of ownership of stock for investment, which could not be considered to be commerce.

The Commission (Br. p. 7) quotes the President's message to Congress transmitting the report of the National Power Policy Committee, as follows:

"We do not seek to prevent the legitimate diversification of investment in operating utility companies by legitimate investment companies. But the holding company in the past has confused the function of control *and management* with that of investment and in consequence has more frequently than not failed in both functions. \* \* \* But an investment company ceases to be an investment company when

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\*All italics in quotations in this brief are supplied unless otherwise noted.

it embarks into business *and management*. *Investment* judgment requires the judicial appraisal of *other people's management*."

The Commission makes the surprising statement (Br. p. 27) that its assertion that petitioner controls its subsidiaries in the sense that "their acts are its acts" is "not explicitly contested". But it is of no consequence that denial was not made *in haec verba* of an assertion that had not been made. Certainly our statement (Main Brief p. 8) that "petitioner has at no time engaged in the business of managing the operations of its public utility operating subsidiaries, or selling them supplies, engineering service or the like" and that "its relation has, essentially, been that of a large investor seeking to promote the sound development of his investment" should be deemed sufficient to take issue.

The Commission's reiterated assertion of "control" by petitioner, obviously intended to be understood in the sense stated at page 27, is made without support of any finding, by the Commission or anyone else, and even without citation of any part of the record believed to sustain it. It is contrary to the only finding on the subject which the Commission made (R., Vol. I, 100-101) that

"As nearly as can be determined from the record in this case, North American leaves operations and operational policy to the management of its subsidiaries".

and to the evidence that petitioner, in its entire history, has never had a service company providing management, construction or other services for compensation (R., Vol. VIII, p. 2903). The Commission's present brief (p. 90) says that "North American's contribution to the management

of its underlying subsidiaries is largely limited to financial matters".

In the case of *Electric Bond & Share Co. v. Securities and Exchange Commission*, 303 U. S. 419, frequently relied on by the Commission in its brief, there was (pp. 431-440) "an elaborate stipulation" and "findings of fact" by the trial court of activities on the part of the defendants in that case which are not at all paralleled in this one. The Commission says (Br. p. 27) that "North American has, either directly or through its subsidiaries engaged in all the types of activities mentioned in the *Bond and Share* case as a basis for federal regulation". That statement is made without any supporting reference. To the extent that it creates the inference that petitioner had servicing subsidiaries, it is incorrect. Moreover, the qualifying phrase "either directly or through its subsidiaries" robs the statement of any significance, because if petitioner's subsidiaries are not its mere instrumentalities so that "their acts are its acts", the operations of the subsidiaries do not determine petitioner's character.

Certainly, we submit, before this Court can uphold the Commission's contention that Section 11 (b)(1), even if not constitutional as to all holding companies, is constitutional as applied to this petitioner, there must be findings of the degree of control asserted as the basis for that contention. There are none.

In the absence of such findings the Commission resorts to reference to other sections of the Act which it asserts have the effect of not requiring any company to comply with Section 11 (b)(1) unless it is interstate in character or "controls" subsidiaries which are so. These are the registration requirements in Section 4, the exemption pro-

visions of Section 3 and the definitions of "holding company" and "subsidiary company" in Sections 2 (a)(7) and 2 (a)(8).

The Commission's argument on Section 4 and Section 3 (Br. pp. 21-24, 33-36) is very slight. With respect to the registration provisions (Section 4) we have nothing to add to the argument in our main brief (pp. 19-21), and with respect to the exemption provisions of Section 3 there is very little that was not anticipated in it (pp. 21-24).

As to Section 3, the Commission attempts an argument (Br., p. 24) based on the declaration set forth in Section 1(c), that the policy of the Act is to meet the problems and eliminate the evils "connected with public-utility-holding companies which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce". We have already commented upon this phrase in our discussion of Section 1 (Main Brief, p. 32). It might be germane if the operative provisions of Section 11 (b)(1), even taken in relation to Sections 3 and 4, were susceptible of a construction which would limit their application to public utility holding companies "which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce". But such a construction is impossible, and none of the argumentation in the Commission's brief supports it.

The Commission's argument based on Sections 2 (a)(7) and 2 (a)(8), defining "holding company" and "subsidiary company", respectively, is that the essential test which they prescribe of the holding company-subsidiary relationship is the "test of control", from which it deduces that no company need comply with Section 11 if it is merely an investor in other companies "and does not control such other companies". For the purpose of that argument, however,

the Commission must use the word "control" in a sense quite different from the meaning which is attached to that term in the other portions of its brief to which we have above referred.

Under Section 2(a)(7) the term "holding company" (and the definition of "subsidiary company" in Section 2(a)(8) is the exact counterpart) includes any company which owns 10 per centum or more of the outstanding voting securities of a public utility company, unless the Commission by order declares such company not to be a holding company. The Commission may not make such a declaratory order unless all three of the following conditions are established by the applicant:

"\* \* \* that the applicant (i) does not, either alone or pursuant to an arrangement or understanding with one or more other persons, directly or indirectly control a public-utility or holding company either through one or more intermediary persons or by any means or device whatsoever, (ii) is not an intermediary company through which such control is exercised, and (iii) does not, directly or indirectly, exercise (either alone or pursuant to an arrangement or understanding with one or more other persons) *such a controlling influence over the management or policies of any public-utility or holding company as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that the applicant be subject to the obligations, duties, and liabilities imposed in this title upon holding companies.*"

This is quite a different thing from merely creating a rebuttable presumption, as the Commission argues (Br. p. 20), that a holding of ten percent of voting securities

constitutes control. The construction of the third requirement relating to "controlling influence" by the Commission, which construction has been upheld by the courts, shows how far it is from "control" in the sense of management so that the subsidiary's acts may properly be deemed to be the acts of the holding company.

In *Detroit Edison Co. v. Securities & Exchange Commission*, 119 F. (2d) 730 (C. C. A. 6), cert. den. 314 U. S. 618, the Court found (p. 738):

"There is no evidence in the record that petitioner [Detroit Edison Company] is controlled, directly or indirectly, by the North American Company, either through one or more intermediary persons or by any means or device whatsoever, and likewise there is no evidence in the record that petitioner is an intermediary company through which such control of another company is exercised."

In spite of this finding, the Court held Detroit Edison to be a subsidiary of North American, because the "latent power" of the latter as a stockholder constituted "controlling influence".

In *Pacific Gas and Electric Co. v. Securities & Exchange Commission*, 127 F. (2d) 378 (C. C. A. 9) the Court held (p. 384) that:

"\* \* \* In view of what we regard as the proper construction of the words in the statute, 'subject to a controlling influence', a finding for the company is not compelled by the fact that North American had not dominated the company in the past."

The Court concluded that the correct construction of the statute was that, even if none of the conditions specified

under Clauses (i), (ii), and (iii) were present, "it could still deny the application on the ground that there was a necessity or appropriateness that the act be held to be applicable to the applicant under the necessity clause" (p. 385). Thus it in effect held that the phrase "so as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that the applicant be subject to the obligations, duties and liabilities imposed in this title upon subsidiary companies of holding companies" constituted a fourth criterion which must be negatived in addition to the preceding three. And that fourth criterion need have no relation to "control".

In *Hartford Gas Co. v. Securities and Exchange Commission*, 129 F. (2d) 794 (C. C. A. 2) the Court, while not in words going to the length to which the Circuit Court of Appeals for the 9th Circuit went in its construction of the "necessary or appropriate" clause, in effect reached about the same result. It said (p. 796):

"\* \* \* Subdivision iii calls for a showing of *extreme negation*. Its requirement is no less than that of *preponderating proof* that the management or policies of the applicant are not subject to a controlling influence, directly or indirectly, by such holding company \* \* \* so as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that the applicant be subject to the obligations, duties, and liabilities imposed in this title [chapter] upon subsidiary companies of holding companies \* \* \*. Decision by the Commission involved both the weighing of the evidence to establish the actual facts and the weighing of the facts against the background of what is 'necessary or appropriate in the public interest or for the protection of investors or consumers'."

*In Public Service Corporation of New Jersey v. Securities and Exchange Commission*, 129 F. (2d) 899 (C. C. A. 3) cert. den., 87 L. Ed. 223, the Court reiterated the doctrine of unexercised power as follows (p. 903):

“\* \* \* A ‘controlling influence’ may exist, although in latent form. *Detroit Edison Co. v. Securities & Exchange Commission*, supra. Even though, after 1938, UGI and United did not utilize their voting strength to elect directors, pass resolutions or veto corporate changes the latent power to do so was a present power to exert a ‘controlling influence’ upon Public Service at any time.”

The above principle was again applied in *American Gas and Electric Company v. Securities and Exchange Commission* (Circuit Court of Appeals for the District of Columbia, Feb. 1, 1943, C.C.H., ¶ 90,196), in spite of the fact that the Electric Bond & Share Company, the holding company there involved, had relinquished most of the features which the Court had relied upon as indicia of control in the past.

Considering the strictness with which the doctrine of administrative finality has been applied in these cases, coupled with the interpretation of Section 2(a)(8) which they have approved, it is apparent that the fact (adverted to in the Commission's brief, p. 13) that in the first two cases above cited the Detroit Edison Company and the Pacific Gas and Electric Company, respectively, were denied orders declaring that they were not subsidiaries of this petitioner is utterly without significance on the issue whether petitioner controlled them in the sense that their acts were its acts, which is the only sense material to the question here involved.

The rules determining whether a company is in "control" of another in the latter sense have been many times enunciated by this Court and are quite different. In *Pullman's Palace Car Co. v. Missouri Pacific Ry. Co.*, 115 U. S. 587, 597, this Court said:

"\* \* \* The Missouri Pacific Company owns enough of the stock of the St. Louis, Iron Mountain and Southern to control the election of directors, and this it has done. The directors now control the road through their own agents and executive officers, and these agents and officers are in no way under the direction of the Missouri Pacific Company. If they or the directors act contrary to the wishes of the Missouri Pacific Company, that company has no power to prevent it, except by the election, at the proper time and in the proper way, of other directors, or by some judicial proceeding for the protection of its interests as a stockholder. Its rights and its powers are those of a stockholder only. It is not the corporation, in the sense of that term as applied to the management of the corporate business or the control of the corporate property."

And in *United States v. Reading Co.*, 253 U. S. 26, 62-63, this Court thus stated the rule as applied to the commodities clause of the Hepburn Act:

"\* \* \* This rule was repeated and applied in *United States v. Delaware, Lackawanna & Western R.R. Co.*, 238 U. S. 516, 529. It results that it may confidently be stated that the law upon this subject now is, that while the ownership by a railroad company of shares of the capital stock of a mining company does not necessarily create an identity of corporate interest between the two such as to render it unlawful under the commodities clause for the railroad

company to transport in interstate commerce the products of such mining company, yet where such ownership of stock is resorted to, *not for the purpose of participating in the affairs of the corporation in which it is held in a manner normal and usual with stockholders*, but for the purpose of making it a mere agent, or instrumentality or department of another company, the courts will look through the forms to the realities of the relation between the companies as if the corporate agency did not exist and will deal with them as the justice of the case may require."

See also *Porter v. Pittsburgh Bessemer Steel Co.*, 120 U. S. 649, 670; *United States v. Lehigh Valley R. R. Co.*, 220 U. S. 257, 274.

In this case it does not appear that petitioner has exercised "control" even to the extent regarded in the above-cited cases as normal to the stockholder relation. The Commission expressly found that petitioner "leaves operations and operational policy to the management of its subsidiaries" (R. Vol. I, 100-101). What does appear is that, in the practice of its policy of local autonomy for its public-utility operating subsidiaries, it has sought to use its voting power to assure good local management which has had the genuine responsibility of conducting operations; that it has furnished financial advice and assistance; and has sponsored the interchange of valuable operating information among the subsidiaries.

These are the things which owners of property, be they corporations or individuals, ordinarily do to promote the sound development of their investments. They are the normal incidents of ownership of securities. If the Commission's contentions here were accepted, every individual

owning substantial security interests in corporations engaged in interstate commerce would himself be deemed on that account to be so engaged, and all his property interests of whatever nature would be held at the sufferance of Congress. He could be required by Congress to divest himself of all his properties except one, including his own home, as petitioner here has been held liable to divestment of its office building, not because his ownership thereof had any effect on interstate commerce but because, among his property interests, he owned ten percent of the voting stock of some company that was engaged in interstate commerce, and was not able to satisfy the Commission that he did not have a "latent power", albeit wholly unexercised, to influence the management by advice or that there was not some other unspecified reason why it was "necessary or appropriate in the public interest" that he should not own so much property.

**b. The Commission's argument based on use of instrumentalities of interstate commerce.**

If the exercise by an owner of corporate securities of the rights normally incident to ownership of such investments (such as influencing the choice of competent management for the corporation, assisting it in securing adequate financing, and the like) is not commerce, it does not become so because he uses interstate trains or interstate telephone and telegraph lines or the mails to maintain contact with his property interests.

The act of communicating may be subject to appropriate regulation by Congress. But it by no means follows, and it is not the law, that the ownership of the property is sub-

ject to the control of Congress just because that ownership is facilitated by such communication. *Federal Baseball Club of Baltimore, Inc. v. National League of Professional Baseball Clubs, et al.*, 259 U. S. 200 was a treble damage suit under the anti-trust laws against the National League and the American League for conspiring to monopolize the baseball business and in the course thereof destroying the Federal League. Mr. Justice Holmes, writing for a unanimous Court, said (pp. 208-209) :

"The business is giving exhibitions of base ball, which are purely state affairs. It is true that, in order to attain for these exhibitions the great popularity that they have achieved, competitions must be arranged between clubs from different cities and States. But the fact that in order to give the exhibitions the Leagues must induce free persons to cross state lines and must arrange and pay for their doing so is not enough to change the character of the business. According to the distinction insisted upon in *Hooper v. California*, 155 U. S. 648, 655, the transport is a mere incident, not the essential thing. That to which it is incident, the exhibition, although made for money would not be called trade or commerce in the commonly accepted use of those words. As it is put by the defendants, personal effort, not related to production, is not a subject of commerce. That which in its consummation is not commerce does not become commerce among the States because the transportation that we have mentioned takes place."

Nor is petitioner's ownership of the securities of other corporations brought under the control of Congress because of the fact that relations between it and its own out-of-

state security holders, such as transmittal of interest, dividends, proxies, notices of meetings, etc., are accomplished by the use of interstate mails or facilities of interstate commerce, as the Commission appears to argue in footnote 12 at pages 20-21 of its brief.\* Apparently the Commission, in this passage, is contending that a corporation may constitutionally be subjected to the requirements of Section 11 (b)(1) for no other reason than that it was required to register under Section 4 (b) because it had distributed securities by means of an interstate public offering at some time since January 1, 1925, and some of such securities are owned by persons not resident in the same state in which the holding company is organized. (See also the argument at Brief, p. 28.) This is an extreme application of the unsound thesis that because a corporation uses interstate facilities of communication for any purpose it is subject to the control of Congress for all purposes.

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\*In this footnote (Br. p. 20) there is a blind reference to the postal power of Congress. The Commission says that it does not understand that we question its conclusion that, "if the relation of holding companies to interstate commerce will sustain the validity of requiring registration under the commerce clause, a similar relation to the use of the mails will sustain similar regulation under the postal power". The reference is blind because the footnote is to a discussion of the application of Section 11 through the requirement of registration under Section 4 (a). If all the Commission means is that use of the mails will sustain appropriate regulation of such use, we have no quarrel with the statement. But if the Commission has vaguely in mind some such *non sequitur* as that, since (i) if a holding company uses the mails for certain purposes Section 4(a) compels it to register, and since (ii) if it registers it is subject to Section 11 (b)(1), therefore (iii), the postal power supports Section 11 (b)(1), we emphatically dissent. " \* \* \* Congress may not exercise its control over the mails to enforce a requirement which lies outside its constitutional province, \* \* \*" (*Electric Bond & Share Co. v. Securities and Exchange Commission*, 303 U. S. 419; 442).

If the relationship of the holding company to the subsidiaries does not constitute commerce by reason of permissible identification of their activities with it, it does not come under the control of Congress for purposes of compulsory divestment of its ownership of securities because of its use of interstate mails, telephones or telegraphs in the maintenance of whatever relationship it has.

The Commission argues (Br. p. 83) that the abuses and opportunities for abuse which Congress found to be inherent in the utilities holding company system depend upon the employment of interstate commerce; and that in these circumstances Congress was at liberty to exercise its power under the commerce clause in an effort to eliminate or ameliorate those abuses. But no question is here involved regarding the legitimacy of so regulating the use of the channels of interstate commerce that such use will not further such abuses. That has been done through provisions of the Act other than Section 11 (b) (1). Sections 6 and 7 deal with security transactions, Section 8 with acquisitions of interests in electric and gas utility companies, Section 9(a)(1) with acquisitions of securities and utility assets and other interests, Section 12 with inter-company loans, dividends, security transactions, sale of utility assets, proxies and other transactions, and Section 13 with service, sales and construction contracts. These sections forbid, either unqualifiedly or unless permitted by the Commission, the effectuation of the various transactions specified therein by use of the mails or any means or instrumentality of interstate commerce.

What the Commission seems to be really arguing on this head, and what it must argue to support Section 11 (b) (1), is that Congress is entitled under the commerce power

to require the disintegration of all existing property ownerships, whether or not they themselves affect interstate commerce, for the reason that their accumulation has been accomplished, or at least facilitated, by use of the mails and the instrumentalities of interstate commerce. No such theory has ever been upheld, and we know of no other act of Congress which has even been based upon an assertion of such a power. The consequences of recognition of any such theory would be without limit. There are few instances in which substantial aggregations of property interests can be built up, either by corporations or by individuals, without the use of the mails or instrumentalities of interstate commerce. It has never been supposed that that fact gives Congress the power to require their owners to dispose of them because it believes that the general welfare would be promoted thereby.

The attempted analogy to the anti-trust laws and the commodities clause of the Hepburn Act (Br. pp. 84-85) wholly fails for the reasons shown in our main brief (pp. 48-51). Where divestment of properties is required by a decree under the former act, or becomes necessary under the latter act if a carrier desires to continue to carry coal, it is solely because a court has found that the continued ownership itself affects interstate commerce to the required degree. Neither act says anything about divestment of properties. Both prescribe rules "by which commerce is to be governed", (*Gibbons v. Ogden*, 9 Wheat. 1, 196) and any interference with property rights is merely an incident to the enforcement of those rules. Section 11 (b) (1) provides no rule for interstate commerce. It applies whether or not the forbidden ownerships have any effect on interstate commerce, as we show at length in the discussion in

our main brief, to which the Commission makes no very serious answer; the rule which it prescribes is one, not by which commerce is to be governed, but by which property ownership is to be governed. It is impossible to bring such a rule within the commerce power on the ground that those who are to be subjected to it either use or have used instrumentalities of interstate commerce.

A statute prescribing the conditions upon which property may be owned can be upheld under the commerce clause only if the very status of ownership is found to have such an effect upon interstate commerce as to bring it within reach of the power of Congress.

**c. The Commission's argument on the alleged declaration by Congress.**

On this branch of the case, the Commission significantly minimizes the supposed congressional declaration in Section 1 of the Act. Major emphasis is placed upon its argument (Br. p. 29) that the mere enactment of Section 11(b)(1) requiring compliance by all registered holding companies was itself a finding that all of them so affect interstate commerce that it is proper to apply its provisions to them. It says (Br. p. 30) "That determination is inherent in the enactment of the statute itself".

In attempted support of this proposition, the Commission (Br. p. 31) refers to *United States v. Ferger*, 250 U. S. 199, and *Virginian Railway Co. v. Federation*, 300 U. S. 515, which were cited by this Court in *United States v. Darby*, 312 U. S. 100, 121, following its statement of the third category of legislation therein enumerated (our Main Brief, pp. 12-13), and also to *Colorado*

v. *United States*, 271 U. S. 153. It says that the statutes sustained by those cases contain no statement by Congress that the activity regulated was related to interstate commerce, so that the finding must have been implied from their mere enactment and "from the character of the regulation applied". The quoted qualification shows the inappropriateness of the reference as support for the proposition advanced by the Commission as applied to Section 11(b)(1).

The statute upheld in *United States v. Ferger, supra*, was "An Act relating to bills of lading in interstate commerce", and purported to protect "the vast volume of interstate commerce operating and moving in reliance upon genuine bills of lading" (p. 205) by the suppression of spurious ones. It required no declaration that the suppression of spurious bills of lading was a protection to the conduct of interstate commerce under genuine bills.

The Railway Labor Act upheld in *Virginian Railway Co. v. Federation, supra*, is far from being an instance where Congress left its determination that interstate commerce was affected wholly to such implication as might be derived from the mere enactment of the operative provisions. As this Court pointed out (300 U. S., p. 553):

"\* \* \* The Railway Labor Act, §2, declares that its purposes, among others, are 'To avoid any interruption to commerce or to the operation of any carrier engaged therein,' and 'to provide for the prompt and orderly settlement of all disputes concerning rates of pay, rules or working conditions.' The provisions of the Act and its history, to which reference has been made, establish that such are its purposes, and that the latter is in aid of the former."

(See our discussion in this case, Main Brief, pp. 40-41.)

*Colorado v. United States, supra*, is not properly cited as belonging to the category of legislation where the only finding of effect upon interstate commerce is that made by Congress itself. That case involved an attack upon the validity of a certificate issued by the Interstate Commerce Commission under the Interstate Commerce Act, as amended by the Transportation Act, that present and future public convenience and necessity permitted the abandonment of an intrastate branch line. The grounds on which the Interstate Commerce Commission granted the certificate permitting abandonment included that for years operation of the branch had resulted in large deficits, that future operation would likewise result in large deficits, that these deficits would have to be made up by the railroad, and that "thus continued operation would constitute an undue burden upon interstate commerce" (271 U. S. p. 160, and discussion of such reasons, p. 163). The Court said (p. 167):

"\* \* \* As every projected abandonment of any part of a railroad engaged in both interstate and intrastate commerce may conceivably involve a conflict between state and national interests, the consent of the Commission must be obtained by the railroad in every case."

The case was therefore one in the second category enumerated in the *Darby* case where Congress leaves it to an administrative agency to determine the effect of a particular activity upon interstate commerce.

The statutes to which this Court referred in the *Darby* case as falling within the third category clearly showed their

interstate-commerce purpose. The unequivocal congressional declaration in the Fair Labor Standards Act of 1938 is quoted in our main brief (pp. 36-37). The declaration of purpose in the Railway Labor Act has already been quoted in our discussion (*supra*) of the *Virginian Railway* case. The third act referred to, the Safety Appliance Act, originally applied only to common carriers engaged in interstate commerce by railroad (27 Stat. 531). It was amended (32 Stat. 943) to "apply to all trains, locomotives, tenders, cars and similar vehicles used *on any railroad engaged in interstate commerce*". This amendment was upheld in *Southern Ry. Co. v. United States*, 222 U. S. 20, the court saying (p. 27):

"Speaking only of railroads which are highways of both interstate and intrastate commerce, *these things are of common knowledge*: Both classes of traffic are at times carried in the same car and when this is not the case the cars in which they are carried are frequently commingled in the same train and in the switching and other movements at terminals. Cars are seldom set apart for exclusive use in moving either class of traffic, but generally are used interchangeably in moving both; and the situation is much the same with trainmen, switchmen and like employes, for they usually, if not necessarily, have to do with both classes of traffic. Besides, the several trains on the same railroad are not independent in point of movement and safety, but are interdependent, for whatever brings delay or disaster to one, or results in disabling one of its operatives, is calculated to impede the progress and imperil the safety of other trains. And so the absence of appropriate safety appliances from any part of any train is a menace not only to that train but to others."

When the relation of an enactment to interstate commerce is self-evident, as in the legislation upheld in the *Ferger* case, or can be readily discerned from facts of common knowledge, as in the case of the Safety Appliance Act, no finding by anyone, court, administrative agency or Congress, is necessary to support its validity. But the mere enactment of a statute asserting Federal power to divest ownership of stocks cannot conceivably fall within such a rule. Ownership is something the incidents of which may or may not affect interstate commerce. It would, therefore, be contrary to the facts to attempt to assimilate this Act to the acts upon which respondent relies, namely, acts where the Congress might legitimately regard the effect on interstate commerce as so obvious that it could be taken for granted.

Moreover, this is not a case where Congress simply passed a statute and left the grounds of its enactment to presumption. It is a matter of common knowledge that Congress entertained grave doubt as to the constitutionality of Section 11 (b), and the elaborate recitals in Section 1 constitute a studied effort to make findings which would, so far as possible, support constitutionality.

The Commission's argument based on the declarations contained in Section 1 is unimpressive. It emphasizes the declaration that when the "abuses" referred to in Section 1(b) "become persistent and widespread the holding company becomes an agency which, *unless regulated*, is injurious to investors, consumers and the general public". But the Act does provide, in sections other than 11(b)(1), for such regulation, and the natural interpretation of the quoted phrase is that it explains the purpose of those regulatory provisions.

The final declaration of intention "to compel the simplification of public-utility holding-company systems and the elimination therefrom of properties detrimental to the proper functioning of such systems, and to provide as soon as practicable for the elimination of public-utility holding companies except as otherwise expressly provided in this title" seems to be based upon the supposition, the fallacy of which we have discussed in the preceding subdivision, that, even in the absence of an interstate-commerce policy, any company which uses the mails or instrumentalities of interstate commerce may be controlled by Congress not only with respect to such use but in any other way that Congress sees fit. Indications of this theory appear in the reasons given in Section 1(a) why holding companies and their subsidiaries are affected with a national public interest. The first three rely on the use of the mails and instrumentalities of interstate commerce. The fourth is that "their practices in respect to and control over subsidiary companies often materially affect the interstate commerce *in which those companies engage.*" But this again refers to "practices" rather than the ownership of the securities itself. And it does not explain the provisions of Section 11(b)(1) which require the divestment of securities in subsidiaries which are not engaged in interstate commerce. Neither does the fifth, relating to the ineffectiveness of control by any state, explain the necessity for the divestment of securities of companies with respect to which there is no such difficulty.

In fact, reliance upon the use of the mails and facilities of interstate commerce is the only common denominator upon which the requirements of Section 11 (b) (1) can rest. Take the systems of the Cleveland Electric Illuminat-

ing Company, the Pacific Gas and Electric Company and the Detroit Edison Company, of all of which petitioner is directed to divest itself. No "practice" of petitioner in respect of them, and no "control" over them, assuming that any such control exists (see Commission's brief, pp. 31-32, footnote 18), can affect any interstate commerce "in which those companies engage" because they engage in none. And they are susceptible of effective control by the states of Ohio, California and Michigan in which their businesses respectively are wholly confined. It is true that to communicate and maintain contact with them petitioner must use interstate mails, trains and telephone and telegraph lines. But that is the only connection with interstate commerce that Section 1 discloses. Take the North American Utility Securities Corporation, a small investment company, or the 60 Broadway Corporation in which petitioner has its offices. On what possible interpretation of Section 1 can it be said to be a declaration by Congress that the prohibition of ownership of the securities of such corporations is for interstate-commerce reasons?

The arresting distinction between Section 11 (b) (1) and any other statute the validity of which under the commerce power has been upheld by this Court is that it does not purport to prescribe a "rule by which commerce is to be governed" (*Gibbons v. Ogden, supra*). And, read as a whole, there is nothing in Section 1 which declares the intention of Congress to enact Section 11 (b) (1) as such a rule. The rule which is enacted is one to prescribe the conditions upon which certain types of property may be owned. Not only is Section 11 (b) (1) part of an Act which this Court has expressly held to be separable (*Electric Bond & Share Co. v. Securities and Exchange*

*Commission*, 303 U. S. 419), but it is an enactment which is distinct in purpose and effect from the other sections of the Act.

The structure of the Act as a whole is quite different from that of the other statutes in connection with which this Court has applied the rule that the commerce power extends to those activities intrastate which so affect interstate commerce, or the exercise of the power of Congress over it, as to make regulation of them an appropriate means for the regulation of interstate commerce. Such statutes have usually prohibited or regulated certain transactions in interstate commerce, and included or added a concomitant regulation or prohibition of similar transactions which are not in interstate commerce but are deemed to have a sufficient effect thereon as to require this. The interstate and intrastate transactions affected being of the same general character, are usually so inter-related that it is impossible to control the former without controlling the latter. Such was the case, for example, with respect to statutes providing for regulation of agricultural commodities or products "in the current of interstate or foreign commerce or which directly burden, obstruct or affect that commerce", considered in *United States v. Rock Royal Cooperative, Inc.*, 307 U. S. 533, and *United States v. Wrightwood Dairy Co.*, 315 U. S. 110, or "to provide an adequate and balanced flow of agricultural commodities in interstate and foreign commerce", like the act upheld in *Wickard v. Filburn*, 87 L. Ed. 57, or regulating sales on the exchange of the Chicago Board of Trade which occasioned the Grain Futures Act, upheld in *Chicago Board of Trade v. Olsen*, 262, U. S. 1 (Commission's Brief, p. 33). In such cases it is enough that the intrastate condition regulated "from

time to times does, directly burden and obstruct commerce between the States in grain, and that it recurs and is a constantly possible danger" (262 U. S., p. 40).

But these principles do not apply when a prohibition of intrastate matters or matters which are not commerce at all is not ancillary to a regulation of interstate commerce. No presumption can be indulged, that such an act is necessary to protect interstate commerce. Here the congressional finding of the required effect upon interstate commerce must relate clearly and unequivocally to the particular subject of property ownership. There is no such finding. It would not be sufficient for a statute like this to find, even if there were such a finding, that some such ownerships "often" have such effect. But the declarations in Section 1 do not even find that, for they speak only of "practices" of a wholly undefined nature, and "control" without specification of what is meant by that term, and do not declare that such "practices" and "control" even "often" materially affect interstate commerce except where the companies whose stocks are owned are engaged in interstate commerce.

The very fact that the conception of "interstate commerce" is one of degree (*Santa Cruz Fruit Packing Co. v. National Labor Relations Board*, 303 U. S. 453, 467) emphasizes that the more drastic and pervasive is the attempted prohibition, the more imperative it is that the necessity for it,—for the protection of interstate commerce and not merely for the general welfare,—clearly appear. There must be some point at which the commerce power of Congress stops. There would be none if declarations such as those in Section 1 here relied on were held conclusive. For, considering the complexities of social and economic relations in this country, it would be difficult to conceive of any condi-

tion which could not be said "often" to have some effect outside of the state in which it obtains. Since, if a particular subject matter be held to be within the commerce power, the control of Congress over it is plenary, and exclusive if it desires to make it so, few things would remain within the control of the states if Congress chose to preempt the field.

**d. The Commission's argument based on "the conservative tradition of federalism".**

The Commission's argument here (Br., pp. 75 *et seq.*) apparently is that Congress did not by this Act preempt the field as completely as it might constitutionally have done under the commerce power. But, whatever the purpose, the argument that "the Act, and Section 11 (b) in particular, are in the conservative tradition of federalism" cannot be accepted.

The specifications of the Commission's contention are contained in footnote 42 (Br., pp. 75-76). They may tend to support the observation so far as some of the regulatory provisions of the Act are concerned, but they utterly fail to support it with respect to "Section 11 (b) in particular".

The only thing that the Commission can find to say about Section 11 (b) (1) is that one of the standards, (C), which govern the permissibility of retention of additional public utility systems requires that such additional systems shall not be so large as to impair, among other things, "the effectiveness of regulation". But that is only one of three standards, all of which must be met to qualify for retention an additional integrated system; the other two have no relation to state regulation. And even as to (C) its

terms, like the other provisions of Section 11 (b)(1), may, as was the case in this very proceeding, permit the retention of an interstate system where all of the difficulties of centering control of its utility operations in a single state obtain, while denying permission to retain several utilities, each a completely local utility and doing business in a single state which, of course, has complete power of regulation.

A far more important violation of "the conservative tradition of federalism", however, lies in the unquestionable fact that Section 11 (b)(1) effectively denies to the states any power to prescribe the rules governing who shall be permitted to own the securities of corporations subject to their laws. There was with respect to this subject no "no man's land" which required congressional intervention. Any state, in the absence of federal legislation, has the right to legislate that voting stock of corporations of its creation shall not be owned by foreign corporations, *Mannington v. Hocking Valley Ry. Co.*, 183 Fed. 133, 156, 157 (C. C. S. D. Ohio) and decisions of this ~~Court~~ cited therein. Different states may feel differently on this subject and due regard for the federal system would leave each state to make its own choice. Many a state may well feel that the influence of holding companies in voting the stock held by them in utility operating companies in favor of well-qualified directors, and assistance in financing and technical advice, is beneficent and on the whole promotes the successful operation of the utilities with corresponding benefit to the citizens of the state. Section 11 (b)(1) makes it impossible for them to adopt and follow that policy.

It may be an appropriate exercise of the federal principle for Congress to supplement state laws by prohibiting the use

of facilities of interstate commerce in such manner as to occasion abuses, as Congress has done in certain sections of this Act other than Section 11 (b) (1). But it is not "in the conservative tradition of federalism" to preempt control of ownership itself, which has been traditionally considered a matter for determination by the states.

## II. THE FIFTH AMENDMENT.

The only parts of the Commission's argument under the due process clause of the Fifth Amendment which require reply are: (1) its attempt to distinguish the case of *Louisville Joint Stock Land Bank v. Radford*, 295 U. S. 555 and (2) its attempt to show that enforcement of the order will not in fact visit loss upon petitioner and its stockholders.

The attempt to distinguish the *Radford* case is upon the grounds (Br. p. 88) that the order in question does not take property from any person and give it to another, and that petitioner's security holders who now own interests in petitioner's subsidiaries indirectly through investment in petitioner will, on compliance with the order, hold those same investments in a different form or they will receive cash in full compensation for those investments.

As to the first ground, it was held that the Frazier-Lemke Act, which was an exercise of the bankruptcy power of the United States, could not deprive a mortgagee of rights which he had under state law; that "If the public

interest requires and permits the taking of property of individual mortgagees to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain." (p. 602) So here, if the "national public interest" demands that part of the property of North American be taken from it and transferred to debenture-holders and preferred stockholders when they have no present right to be paid off, the loss sustained by North American and its common stockholders must be compensated for in proceedings in eminent domain, just as in the *Radford* case the loss sustained by the mortgagee through the deprivation of his rights was required to be compensated for.\*

As to the second asserted ground of distinction above stated, it is not correct to say that petitioner's stockholders will after enforcement of the order hold the same investments in a different form or will receive cash in full compensation for those investments. Entirely apart from the necessity of paying off over \$100,000,000 of senior securities, either in cash or in securities in kind at present valuations comparable to the amounts of cash to which they would become entitled on maturity, the common stockholders cannot receive the same investment in any form because the cardinal element of the investment, the benefit of common management of diversified investments, is destroyed. (See our Main Brief, pp. 60-62). If, as the Commission argues (Br. p. 90), Congress concluded that the economic

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\*There is nothing in the later case of *Wright v. Vinton Branch*, 300 U. S. 440, upholding the second Frazier-Lemke Act which in the slightest degree impairs the authority of the *Radford* case. The opinion in the later case was written by the same justice and its ground was that the full substance of the property rights of which the first Act had deprived the mortgagee were preserved to him in the second Act.

advantages from the continuance of holding company ownership of securities of operating utility companies were not commensurate with the economic, social and political disadvantages, its constitutional course under the doctrine of the *Radford* case was to resort to condemnation so that, through taxation, the burden of such promotion of the public interest might be borne by the public.

Petitioner's common stockholders cannot receive full compensation for their investments because, among other things, of the enormous destruction of values which will inevitably attend forced dispositions of underlying securities to satisfy the legal claims of holders of petitioner's debentures and preferred stocks (our Main Brief pp. 64-65). Nothing in the Commission's brief presents any satisfactory explanation of how the claims of holders of something over \$100,000,000 of these senior securities may be discharged without such sacrifices.

The Commission refers (Br., p. 91) to the reorganization machinery provided in Sections 11 (d) and 11 (e). But for any plan under those sections to be approved it must be found "fair and equitable". With respect to footnote 48 (Br., p. 92), since petitioner is amply solvent by every test, no plan which required debenture holders and preferred stockholders to take less than the dollars to which they are entitled, or securities of a value less than the face amount of their claims, would, we assume, be found "fair and equitable". Even in bankruptcy, if petitioner were insolvent, a plan which provided for less than full payment to them before anything went to common stockholders, in the absence of contribution in money or in money's worth on the latter's part, would be unfair under the rule of priorities enunciated in *Case v. Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106. The debenture holders

and preferred stockholders will not *voluntarily* take securities in place of dollars unless at values at which the securities can, in their opinion, be liquidated in sufficient volume to produce the dollars to which they are entitled. To require them to take less, in the interests of preserving more value for the common stockholders, would merely shift the deprivation of property without due process, which enforcement of Section 11 (b)(1) accomplishes, from the common stockholders to the debenture holders and preferred stockholders.

If the divestment is effected by a plan of reorganization which calls for exchanging underlying stocks for petitioner's debentures and preferred stocks, those underlying stocks must be valued for the purpose on a basis which will be tantamount to a forced liquidation at the expense of the common stockholders (see our Main Brief pp. 64-65). To point out that this basis of liquidation is "fair and equitable" as between the senior security holders on the one hand, and the common stockholders on the other hand, is to beg the question. The Commission and the courts may competently determine the relative fairness of the distribution involved in the plan as between the two groups of security holders, but they are powerless to preserve for the common stockholders the real and important factors of value in their stock which are destroyed by the break-up of the holding company (see our Main Brief pp. 61-63) and to prevent the further loss to the common stockholders which would follow from the forced liquidation, regardless of whether the senior security holders are paid off in cash or by distribution of underlying assets in kind (see our Main Brief pp. 64-65).

The point is not, as the Commission seems to suppose (Br. p. 95), whether the present market is probably lower or higher than it will be in future. The point is that the effect of Sections 11 (b), (d) and (e) is to force petitioner into a "reorganization", which is not a continuation of the enterprise, but is a break-up of the solvent going enterprise, with the inevitable losses to the common stockholders attendant upon that break-up.

The point is also not, as the Commission seems to suppose (footnote 45, Br. pp. 88-89), whether the estimated liquidating value of the common stock of petitioner on a certain date, as computed by a statistician, was greater or less than the market price of the common stock of petitioner on that date. Such computations involve so many variables and ~~perforce~~ involve so much guess work, that they are not relied upon even by speculators, as proved by the fact that the actual purchases and sales on the market, cited by the Commission, are at prices which bear no realistic relation to the computations. Many of petitioner's underlying assets are closely held and have no quoted market value. The market time lag between the date of such computations and the prospective date of realization, the uncertainties involved in the market reaction to the forced release of very large blocks of stocks and the uncertainties involved in the settlement of large unliquidated claims at once destroy the specious certainty of the figures cited by the Commission. Such computations are designed to appeal to speculators and do not in any way disprove the very real destruction of values and consequent losses which must be borne by petitioner's common stockholders as *investors* in a going enterprise lawfully established fifty-three years ago and lawfully conducted since then.

Finally must be considered the argument of the Commission (Br. pp. 95-96) that, although since 1935 peti-

tioner has been on notice that it must limit its operations in accordance with Section 11, it has not chosen to avail itself of the provisions of Section 11 (e), but has waited until ordered to comply with Section 11 (b)(1). The argument apparently is that petitioner has only itself to blame for any "market loss" resulting from not picking the highest market which occurred after 1935 and not selling or distributing its assets on that market. Petitioner has already shown that a conception of loss to the common stockholders, based merely on market conditions at the time of divestment, is inadequate and fallacious.

But, apart from that, certainly petitioner's management cannot fairly be criticised for not voluntarily incurring the destruction of values which compliance at any time would have entailed (see our Main Brief, pp. 64-65). As this Court, by Mr. Justice Cardozo, said in *Landis et al. v. The North American Company*, 299 U. S. 248, 256:

"\* \* \* In these Holding Company Act cases great issues are involved, great in their complexity, great in their significance. On the facts there will be need for the minute investigation of intercorporate relations, linked in a web of baffling intricacy. On the law there will be novel problems of far-reaching importance to the parties and the public."

A board of directors and a management which permitted the visitation upon stockholders of the losses which would be entailed by voluntary compliance with an act of such doubtful validity, without first appealing to the courts, might well be chargeable with default in their fiduciary obligations. *Pollock v. Farmers' Loan & Trust Co.*, 157 U. S. 429; *Hill v. Wallace*, 259 U. S. 44; *Ashwander v. Tennessee Valley Authority*, 297 U. S. 288, 319.

### III. CONCLUSION.

The Commission's brief narrates many interstate activities which are imputed to petitioner, mostly without reference to the Record, and which are imputed to other holding companies. Many of these are of a kind that would be engaged in by any large investor.

It may be conceded, for present purposes, that many such activities may be subject to federal regulation. Indeed, as we have shown in our main brief (pp. 67-70) they have, so far as utility holding companies are concerned, been very completely subjected to federal regulation. This is accomplished by sections of the Act other than Section 11(b)(1). The heart of Section 11(b)(1) is not regulation of any interstate activity, but is divestment of ownership. It is *ownership per se* that is struck at as something that is subject to be ordered about, and shifted hither and thither, at the bidding of an agency of the federal government.

Congress made no finding that utility holding company ownership *per se* affects interstate commerce. There was a constitutional necessity of limiting the scope of Section 11(b)(1) to situations and activities such as have in fact a material effect on interstate commerce. This constitutional requirement is, we have seen, not met by limiting Section 11(b)(1) to "registered" holding companies—for holding companies were required to register if, for example, they had outstanding any security which, by use of the mails, had been distributed ten years before the enactment of the Act. Nor, as we have seen in our main brief (pp. 21-24), is such constitutional requirement met by the exemption possibility provided by Section 3(a).

In fact the Congress, although making clear that utility company ownership did not necessarily involve any material effect on interstate commerce, failed to reflect that fact by either limiting the scope of Section 11(b)(1) or limiting the applicability of Section 11(b)(1) to cases where such a finding would be made.

The Commission has accordingly made no finding that the different ownerships of which the petitioner is required to be divested each and all affect interstate commerce, nor could it possibly have made any such finding as regards them all. The court below was not requested to make any such finding. Indeed, no such finding could be made except upon facts so tenuous that, if they were held legally adequate, there would be demolished completely all effective demarcation between federal and state authority.

Our argument is not a technical one. Our complaint is that we are denied the opportunity to make that showing to which due process would entitle us. If Congress had required as a precedent to Section 11(b)(1) action a finding that the ownerships dealt with adversely affected interstate commerce, then there would have been the opportunity, which so far has been denied to petitioner, to show that its ownership of various securities and its practices in relation thereto have been such as not so to affect interstate commerce as to permit destruction of the enterprise through resort to the commerce clause, and indeed that its policies as owner have not been of the character that the Commission's brief insinuates with reference to the petitioner and charges with respect to other utility holding companies which may have adopted policies quite different from those of The North American Company.

None of these questions were at issue in the proceedings before the Commission herein, nor was the Commission willing to make them the subject of findings, this not being contemplated by the Act. This substantive defect is fatal from the standpoint of constitutionality, both under the interstate commerce clause and under the due process clause.

Respectfully submitted,

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